

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

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| Ohio Power Company | Docket Nos. ER03-400-001 ER03-400-002 |
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| Indiana Michigan Power Co. | Docket Nos. ER03-403-001 ER03-403-002 ER03-403-003 ER03-403-004 |
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ORDER ON COMPLIANCE FILINGS AND REHEARING

(Issued September 9, 2003)

1. On April 10, 2003, American Electric Power Service Corporation, on behalf of Ohio Power Company and Indiana Michigan Power Company (collectively, AEP), Michigan Electric Transmission Company, L.L.C. (METC) and Midwest Independent Transmission System Operator (Midwest ISO) filed requests for rehearing of the Commission's March 11, 2003 order¹ issued in these proceedings. As discussed below, in this order, we deny rehearing in part and grant rehearing in part. We also accept the compliance filings submitted in this proceeding, subject to modifications, to be effective March 11, 2003 in Docket No. ER03-400-001 and March 14 and September 22, 2003 in Docket Nos. ER03-403-001 and ER03-403-004, respectively.

Background

2. On January 10, 2003, Ohio Power Company (Ohio Power) submitted for filing, in Docket No. ER03-400-000, an executed interconnection and operating agreement (IOA) between AEP and DPC Northeast Power, LLC (DPC) that grants DPC an interconnection between DPC's generating facility and AEP's transmission system and provides for the construction at the Southwest Lima Station of a bay position, circuit breakers, metering and associated facilities. The IOA also provides for the installation of switches,

¹Ohio Power Co., 102 FERC ¶ 61,269 (2003) (March 11 Order).

associated facilities and the reconductoring of 138 kV lines in and around the Southwest Lima Station.

3. On January 13, 2003, Indiana Michigan Power Company (Indiana Michigan) submitted for filing, in Docket No. ER03-403-000, an unexecuted IOA between AEP and South Shore Power L.L.C. (South Shore) for the interconnection of a generating facility between South Shore's generating facility and AEP's transmission system. The IOA provides for the construction of a bay position, circuit breakers, metering, bus insulators at the Cook Station and associated facilities at the D.C. Cook and other stations.

4. In the March 11 Order, the Commission accepted both IOAs, subject to certain modifications. The Commission required that the IOAs be revised in accordance with its finding that the D.C. Cook station and Southwestern Lima station were network upgrades for which the generators must receive credits with interest. The Commission also required revisions to the IOA in Docket No. ER03-403-000 concerning the duration of the tax indemnification obligation and the maintenance of security for potential tax liability associated with the interconnection.

5. The Commission also determined that the IOA in Docket No. ER03-403-000 should not be subject to conditions related to effects on other transmission systems. The Commission found that interconnection agreements were not the appropriate vehicle to address responsibilities for upgrades on other systems. The Commission stated that the IOA requires the parties to comply with applicable RTO, NERC and ECAR standards and offered its Dispute Resolution Service to help the parties fulfill their obligations.

Discussion

I. Rehearing

6. AEP seeks rehearing of the classification of facilities as system upgrades in both proceedings and certain tax indemnification provisions in the proposed IOA between AEP and South Shore filed in Docket No. ER03-400-002. METC and Midwest ISO jointly request rehearing in Docket No. ER03-403-002 concerning the effects on other transmission systems.

A. Network Upgrades

7. On rehearing, AEP contends that the Commission has applied a "locational bright line" test to change the classification of facilities from interconnection facilities to system facilities and upgrades. AEP argues that the Commission's classification of network

facilities does not consider the purpose of the facility or whether any other customers benefit. AEP specifically objects to the classification of the additional circuit breaker requested by South Shore as a network facility, and claims that AEP and its other customers potentially bear the cost of a facility that "was added at the sole initiative and for the sole benefit of the generator, depending solely on its location in the interconnection configuration."

8. We reject AEP's argument that the Commission's classification of network facilities does not consider the purpose of the facility or whether any other customers benefit. In accordance with Commission policy² and court precedent,

²See, e.g., *Illinois Power Co.*, 103 FERC ¶ 61,032 (2003) (affirming Commission policy that the integrated grid is a cohesive network, the expansion of which benefits all users of the grid, and rejecting the direct assignment of integrated facilities even if those facilities would not have been installed but for a particular request for service); *Tampa Electric Co.*, 99 FERC ¶ 61,192 (2002) (finding that "even if the customer causes the addition of a grid facility (that is, the facility would not be needed 'but for' the customer's request for service), the addition is a system expansion that benefits all users"). See also *Standardization of Generator Interconnections and Procedures*, Order No. 2003, FERC Stats. & Regs. ¶ 31,146 at P 694 (2003) (explaining the rationale for the Commission's crediting policy); *Entergy Services, Inc. v. FERC*, 319 F.3d 536 at 543-544 (2003) (upholding the Commission's transmission crediting policy for short-circuit and stability network upgrades that facilitate network expansion as they benefit all users of the transmission system).

we have properly determined that the D.C. Cook station and Southwestern Lima Station are network facilities as they are integral parts of the grid, and all facilities at or beyond the point where the generator connects to the grid are network facilities that benefit all users of the grid. These network facilities are not directly assigned even if the customer causes the addition of a grid facility.³

B. Tax Provisions

1. Tax Indemnification Limit

9. AEP argues on rehearing that the March 11 Order added vague and ambiguous language to Section 5.3(c) of the IOA between AEP and South Shore Power. The March 11 Order required the following language to be added to Section 5.3(c) of the IOA stating that indemnification for taxes is terminated:

at the earlier of (i) the expiration of the 10-year testing period, as contemplated by IRS Notice 88-129, and the applicable statute of limitation, as it may be extended by the Company upon the request of the IRS, to keep these years open for audit or adjustment, or (ii) the occurrence of a subsequent taxable event contemplated by this Section 5.3.

AEP states that Section 5.3(c)(ii) read literally means that there would be no tax indemnification for a subsequent taxable event, as the event itself would terminate the indemnification.

10. AEP also contends that terminating the tax indemnification after a 10-year or other time limitation would unfairly shift tax risk to the transmission owner. AEP asserts that this issue should be addressed in a Commission rulemaking and not on a case-by-case basis. Further, AEP argues that the Commission mistakenly relied on its decision in American Electric Power Service Corp., 99 FERC ¶ 61,312 (2002) (AEP), regarding the 10-year limit on tax indemnification. It contends that AEP is distinguishable from the instant case in part because AEP

³Id.

involved facts that, unlike this proceeding, clearly fell within the safe harbor conditions of IRS Notice 2001-82, thereby minimizing the tax risk.

11. We agree that a literal reading of Section 5.3(c) could prevent AEP from receiving tax indemnification because a subsequent taxable event would terminate the indemnification. We clarify that indemnification will terminate at the earlier of the expiration of the 10-year testing period (as contemplated by the IRS safe harbor provisions or the applicable statute of limitations) or the occurrence of a subsequent taxable event and the payment of any related indemnification obligations. The clarification ensures that AEP would receive tax indemnification for the occurrence of a subsequent taxable event.⁴

12. We disagree with AEP's argument that the new language added to Section 5.3(c) of the IOA by the March 11 Order does not address the tax risk that AEP and other transmission providers would experience. The period for the indemnification obligation is reasonable because once the earlier of either of these events occurs, there is no further risk of new tax liability and, therefore, no further need for indemnification.⁵ Accordingly, we will reject AEP's proposed language.

2. Tax Security

13. AEP also opposes the March 11 Order's requirement of additional language to Section 5.1(i) of the IOA, which would reduce the amount of guarantee or the value of a letter of credit annually by fixed percentages. It asserts that the reduction percentages listed in the appendix are estimates of the reduction of the tax exposure and argues that the potential tax exposure from a subsequent taxable event cannot be easily predicted from a subsequent taxable event. In addition, AEP expresses concern regarding significant administrative burdens and security renewal difficulties that would face both the utility and the generator under this requirement, and also asks who will bear the burden of notifying South Shore when a taxable year closes.

14. AEP's arguments against the reduction in the value of the letter of credit for a potential tax liability are unavailing. The requirement for the guarantee is related to the remaining tax liability after construction on the interconnection is completed. We find it reasonable for South Shore's security to be reduced as its potential tax liability decreases so that South Shore does not have to provide excessive security over the period of the agreement. Indemnification will remain

⁴See, e.g., San Diego Gas & Electric Co., 102 FERC ¶ 61,063 (2003), San Diego Gas & Electric Co. IA, Section 10.11.3 (vi); Order No. 2003, LGIA, Article 5.17.3.

⁵ See Order No. 2003 at P 451.

effective for the full amount of the tax liability, regardless of the amount of security.⁶ We further note that AEP has failed to demonstrate that the fixed reduction in the value of the letter of credit required of South Shore is based on unreasonable estimates. Therefore, we deny rehearing on this issue.

C. Impact of Interconnection on Third Party Systems

15. In their joint request for rehearing, METC and Midwest ISO contend that the Commission failed to address their arguments concerning: (1) the harmful impact on reliability, (2) the potential impact on Michigan import and export capability, or (3) who should pay for any necessary upgrades. They state that the Commission does not explain how the relief it offers will protect against any third-party impact despite the Commission's admission of the need to protect reliability on other systems. They assert that the March 11 Order does not address the rationale of a policy that requires a generator to only address effects on the system with which it would interconnect but not effects on nearby adjacent systems that are owned by different entities.

16. METC and Midwest ISO also argue that the Commission's proposed remedy that AEP and South Shore adhere to applicable RTO, NERC and ECAR requirements may not have provided adequate relief if either do not comply. They assert that this requirement is meaningless because: (1) AEP is not yet in an RTO (and it would join PJM rather than Midwest ISO, in which METC is participating); (2) it is uncertain when AEP will turn over functional control of its facilities to an RTO; and (3) there are no seams agreements requiring AEP or South Shore to address impacts on METC or other third party systems. Further, they contend that if AEP or South Shore fail to take necessary measures, an alternative course of action such as utilizing the Commission's Dispute Resolution Services or filing a complaint with the Commission may prove to be unduly time consuming. They argue that taking action without the participation of AEP or South Shore may result in sub-optimal corrective measures whose costs would unfairly fall upon METC, Midwest ISO or their transmission customers. They request that the Commission condition its approval of the proposed IOA upon completion of the necessary studies concerning the impacts of the interconnection.

17. We deny rehearing regarding METC and the Midwest ISO's request that South Shore demonstrate that its interconnection with the transmission system of Indiana Michigan would not result in significant harm. The Commission does not

⁶The Commission approved a similar provision in an IA between SDG&E and TDM (SDG&E IA) in San Diego Gas & Electric Co., 102 FERC ¶ 61,063 (2003) (see Section 10.22 and Part 3 of Appendix H of the SDG&E IA).

hold newly interconnecting generators responsible for upgrades on all interconnection systems as this would create obstacles to the construction of new generation.⁷ Our intent here is to prevent AEP or any transmission provider from using third party effects as an excuse for not proceeding with the design, procurement, and construction of an interconnection facility and any necessary upgrades. We clarify, however, that AEP must act in accordance with applicable reliability standards even if such standards require that it keep a circuit open to an interconnecting generator if closing it would degrade reliability on a third-party transmission system.⁸ And under the terms of the IOA, AEP remains responsible for reliably operating its transmission system.⁹ AEP must fulfill this obligation, together with the applicable reliability standards established by NERC or others.

18. We further note that it is unlikely that an interconnection alone would affect the reliability of a neighboring transmission system.¹⁰ But in the rare event that an interconnection alone may cause a reliability problem on neighboring systems, AEP's OATT would govern. AEP's OATT makes the transmission customer chiefly responsible for facilities on other systems, with AEP's assistance.¹¹ In fact, METC and Midwest ISO have entered into an agreement with South Shore to undertake the necessary studies.¹²

⁷ See Tampa Electric Co., 103 FERC ¶ 61,047 (2003); American Electric Power Service Corp., 102 FERC ¶ 61,336 (2003); see also Nevada Power Co., 97 FERC ¶61,227 (2001), reh'g denied, 99 FERC ¶ 61,347 at 62,494-95 (2002).

⁸ See Tampa Electric Co., 103 FERC ¶ 61,047 (2003).

⁹ Article 13.13 of the IOA provides that "Company and Generating Company shall discharge any and all obligations under this Agreement in a prudent manner and in accordance with Good Utility Practice."

¹⁰ See Order No. 2003, FERC Stats. & Regs. ¶ 31,146 at P 118.

¹¹ Section 13.1 of the AEP OATT provides:

The transmission provider will not be responsible for making arrangements for any necessary engineering, permitting and construction of transmission or distribution facilities on the systems of any other entity or for obtaining any regulatory approval for such facilities. The transmission provider will undertake reasonable efforts to assist the transmission customer in obtaining such arrangements, including with limitation, providing any information or data required by such other electric system pursuant to Good Utility Practice

¹² See METC and Midwest ISO Reh'g Request at n.12.

II. Compliance Filings

19. The March 11 Order directed Indiana Michigan and Ohio Power to make revisions reflecting that the subject facilities in the IOAs were network upgrades for which the generators would receive credits with interest. The March 11 Order also required revisions to the IOA in Docket No. ER03-403-000 concerning the duration of the tax indemnification obligation and maintenance of security for potential tax liability associated with the interconnection.

Docket No. ER03-400-001

20. On April 7, 2003, AEP, on behalf of Ohio Power, submitted its compliance filing in response to the March 11 Order. In that filing, AEP revised its IOA to clarify that facilities at the Southwest Lima Station at or beyond the point of interconnection are network facilities and that DPC will be eligible for a credit for transmission service for the costs borne by DPC for such network costs.¹³ AEP also amended Appendices A and E of the Agreement to reclassify these facilities as network upgrades. AEP requests an effective date of March 11, 2003, for the amendments.

Docket Nos. ER03-403-001, ER03-403-004

21. On April 7, 2003, AEP, on behalf of Indiana Michigan, submitted its compliance filing in Docket No. ER03-403-001 in response to the March 11 Order. In that filing, AEP revised its IOA to clarify that facilities at the D.C. Cook Station at or beyond the point of interconnection are network facilities for which DPC will be eligible to receive credits with interest for transmission service for the costs borne by DPC for such network costs. AEP also amended Appendices A and E of the Agreement to reclassify these facilities as network upgrades. AEP revised Section 5.3 by adding language providing for a limit on generating company's tax indemnification obligation and added language to Section 5.1 to provide for the maintenance of security for potential tax liability. AEP requests an effective date of March 14, 2003 for the amendments.

22. On July 25, 2003, AEP filed an amended IOA in Docket No. ER03-403-004 to reflect a 365 day delay in construction (with an expected service date of June 1, 2006) requested by South Shore Power, and the cancellation of another merchant generating project, that, under the terms of the IOA, resulted in South

¹³See Section 3.7 of the AEP and DPC IOA.

Shore bearing responsibility for the replacement of six 345 kV circuit breakers at the Cook Station. AEP requests an effective date of September 22, 2003.

23. Notices of the compliance filings submitted by AEP on behalf of Ohio Power in Docket No. ER03-400-001 and Docket No. ER03-403-001 were published in 68 Fed. Reg. 19,524 (2003) with interventions, comments and protests due on or before April 28, 2003. Notice of the compliance filing submitted in Docket No. ER03-403-004 was published in 68 Fed. Reg. 46,598 (2003) with interventions, comments and protests due on or before August 15, 2003. No protests or comments were filed.

Commission Response

24. Our review of the compliance filings indicates that Indiana Michigan and Ohio Power complied with the Commission's directives. We direct them to make the modifications discussed above within 30 days of the date of this order.

The Commission orders:

(A) AEP's, METC's and Midwest ISO's requests for rehearing are hereby denied in part and granted in part, as discussed in the body of this order.

(B) Indiana Michigan's and Ohio Power's compliance filings are accepted for filing, subject to modification, as discussed in the body of this order. They are directed to modify their interconnection agreements, as indicated in the body of this order, within 30 days of the date of this order.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.